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In the Supreme Court of the United States

OCTOBER TERM, 1955

No. 26

UNITED STATES OF AMERICA, PETITIONER

v.

ANDERSON, CLAYTON & CO.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

OPINION BELOW

The opinion of the Court of Claims (R. 15-23) is reported at 122 F. Supp. 837.

JURISDICTION

The judgment of the Court of Claims was entered on July 13, 1954 (R. 15). A motion on behalf of the United States for a new trial or for a rehearing was denied on October 5, 1954 (R. 30-31). The petition for a writ of certiorari was filed on December 31, 1954, and was granted on February 7, 1955 (R. 87). The jurisdiction of this Court rests on 28 U.S.C. 1255(1).

QUESTION PRESENTED

Whether a corporation which purchases its own shares, holds them in its treasury, and resells them at a profit is taxable on the gain under Section 22(a) of the Internal Revenue Code of 1939 and the applicable Treasury Regulations.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing) of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U.S.C. 22.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.22(a)-15. *Acquisition or Disposition by a Corporation of its Own Capital Stock.*— Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

But if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Internal Revenue Code.

Sec. 29.22(a)-20. *Gross Income of Corporation in Liquidation.*— * * * No gain or loss is

realized by a corporation from the mere distribution of its assets in kind in partial or complete liquidation, however they may have appreciated or depreciated in value since their acquisition. * * *

STATEMENT

The material facts as found by the Court of Claims (R. 23-30) may be summarized as follows:

The taxpayer, a Delaware corporation, with its principal office in Houston, Texas, was organized on December 31, 1929. Its original capitalization consisted of $25,842,375 of first preferred stock and $100,000 in common stock. The common stock, consisting of 100,000 shares with a stated value of $1 per share, was issued to its chief managing officials, 44,800 being issued to W. L. Clayton, 31,000 to M. D. Anderson, and the remainder, in varying amounts, to ten other managing officials. This distribution was intended to reward and retain competent management, an objective which was deemed by the taxpayer of primary importance to the success of its cotton merchandising business. (R. 23-24.)

From the beginning, it was understood by the holders of the common, all of whom were active in the business, that the stock could not be sold to persons other than the managing executives, and that even within that group disposition was to be made according to their respective responsibilities and contributions to management, as determined by the holders of at least seventy-five per cent of the common stock. It was further under-

stood that no stockholder was entitled to sell his stock, or to keep it, except as directed by the holders of at least seventy-five percent of the common stock, and that the respective interests of the holders of the common stock would be adjusted among the managerial group as responsibilities changed. (R. 24.)

In 1931, these restrictions upon the holding and disposition of the common stock were embodied in a written agreement between the taxpayer and all the common stockholders. The agreement required the holders to endorse their stock to Anderson, as trustee, for a period of ten years, but they retained the right to vote their stock, and to receive dividends. The agreement provided that upon the death of any common stockholder, the taxpayer would purchase his stock at the book value as of the preceding July 31, adjusted to reflect appreciation or depreciation of the corporate assets. Any common stockholder could elect, or upon request of the holders of seventy-five percent of the stock was required, to sell his stock to the taxpayer, and in the absence of an agreement as to price the adjusted book value figure applicable in the case of death was to be used as the price. Any stock purchased by the taxpayer could be sold to the remaining stockholders, or to any other person designated by the holders of seventy-five percent of the stock. (R. 24-26.) The agreement was extended in 1943 with modifications which are not material here (R. 28).

From time to time, as junior officials assumed

more responsibilities and duties, common stock was transferred to them by Clayton and Anderson so that upon his death in 1939 Anderson held only 18,574 shares of the 31,000 originally issued to him. On December 15, 1939, the taxpayer purchased those 18,574 shares from his estate at $50.79 per share, its valuation under the contract. During its fiscal year ending July 31, 1944 (the taxable year involved), the taxpayer sold to five of its officials at $112.68 per share, 6,500 of the 18,574 shares which it had acquired from the Anderson estate. No part of the $402,285 difference between the total sales price of $732,420 and the amount of $330,135 which it had paid to the Anderson estate for the 6,500 shares was reported by the taxpayer for income tax purposes.[1] (R. 26-28.)

The common stock bought from time to time from shareholders was not cancelled or retired, but was held in taxpayer's treasury.[2] The treasury stock was not voted at meetings of stockholders; nor taken into account in the payment of dividends or in arriving at book value under the agreement, nor was it reflected as outstanding in taxpayer's financial statements. During the taxable year, the taxpayer had no authorized, unissued capital stock. (R. 29.)

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[1] On its books, taxpayer credited the difference to an account called "Capital Surplus." See Finding 14, R. 27; cf. Finding 23, R. 28.

[2] Between 1932 and 1943, taxpayer on fifteen occasions purchased shares of its own common stock or sold shares held in its Treasury. (See Ex. No. 2, R. 43.)

The purchase of the 18,574 shares from the Anderson estate in 1939 was in conformity with the plan that the shares be resold to active management officials. The resale of the 6,500 shares during the taxable year was to adjust the respective holdings of the taxpayer's officials in accordance with responsibility, and to reward managerial performance. (R. 29-30.)[3]

The Commissioner of Internal Revenue determined that the taxpayer during the taxable year realized a long-term capital gain in the amount of $402,285, the difference between the purchase and resale price of the 6,500 shares in question, on which the tax was $100,571.25, and (with adjustments not here material) arrived at a deficiency of $89,337.66, which was paid by the taxpayer. (R. 30.) After rejection of its claim for refund (R. 30), the taxpayer instituted the present action. The Court of Claims, holding that the gain was not taxable under Section 22(a) of the Internal Revenue Code of 1939 and the applicable Treasury Regulations, rendered judgment in taxpayer's favor (R. 15-23, 30). A timely motion for rehearing or for a new trial was filed by the United States

[3] The Court of Claims also included in its findings of fact (Nos. 28 and 29, R. 29-30) statements to the effect that taxpayer was not dealing in its stock as it might in the stock of another corporation, but those statements are in our view conclusions phrased in the words of the applicable Regulations (Sec. 29.22(a)-15 of Treasury Regulations 111, *supra*). The statement by the Court in Finding 27 (R. 29), to the effect that taxpayer's purchases and sales were nothing more than withdrawals and contributions by the stockholders of its accumulated earnings, is likewise a conclusion.

and was denied by the Court without opinion (R. 30-31).

SUMMARY OF ARGUMENT

In holding that the taxpayer corporation realized no taxable gain from the purchase and resale of its "treasury stock", the court below failed to apply Section 22(a) of the Internal Revenue Code of 1939 and misconstrued the implementing Treasury Regulations. Its decision is squarely contrary to those of every Court of Appeals which has passed upon the question, as well as to the latest decision of the Tax Court.

Section 22(a), *supra*, p. 2, comprehensively defines gross income as including gains "derived from any source whatever," and this Court has repeatedly held that Congress intended in that section to embrace every kind of constitutionally taxable income. In this case, taxpayer admittedly purchased its own shares from the estate of a deceased stockholder-executive with a view to reselling them to other executives, held them in its treasury pending their resale, and did resell them at a price exceeding their cost. As a result taxpayer realized a cash addition to its net worth, amounting to the difference between the cost and selling price of the shares. This increase represents an economic gain falling within the scope of Section 22(a). There is no provision in the 1939 Code which exempts the gain from tax.

The applicable Treasury Regulations, *supra*, pp. 3-4, do not warrant the view, upon which the decision below rests, that purchases and sales of

treasury stock by a corporation must be treated as tax-free readjustments of its capital. The Regulations expressly recognize that no taxable gain or deductible loss is realized by a corporation upon an original issuance of its shares, or upon a redemption of its shares in partial liquidation; such transactions truly represent permanent readjustments of the corporation's capital, the former an increase and the latter a decrease of its outstanding capital stock. However, in harmony with Section 22(a), the Regulations also explicitly provide that "if a corporation deals in its own shares as it might in the shares of another corporation," the resulting gain or loss must be taken into account in computing the corporation's taxable income. Thus the basic test of taxability or deductibility under the Regulations is whether the corporation is revising its capital structure or simply dealing in its shares. A corporation which purchases some of its shares not for retirement but for resale, and does resell them, is not successively undergoing a downward and upward capital adjustment. On the contrary, it "deals" in its own shares as it "might" in those of any other corporation, or indeed in any other property, within the purview of the Regulations. And if so deals in them whether the shares are bought and resold in the open market or pursuant to a private contract, whether they are resold to strangers or to persons already affiliated with the corporation, and whether the transaction was designed to profit

the corporation or the selling stockholder or the purchasing stockholder or all three.

Under no tenable theory may the instant purchase-resale transaction be broken down into two separate and unrelated adjustments of taxpayer's capital. When the transaction is viewed as a whole, as it must be, and in the light of the program of similar purchases and resales of which it was a part, it is clear that the sole purpose and net effect of the transaction was a change in the identity of taxpayer's stockholders rather than a change in its capital structure. Indeed, since the purchased shares were never retired but were retained in taxpayer's treasury and resold, and since both the puchase and resale were made pursuant to a pre-arranged plan embodied in a contract between taxpayer and its stockholders, the conclusion is inescapable that the purchase and resale were interrelated steps in a single transaction effectuating a shift in ownership of the stock—not successive revisions of the corporation's capital.

The court below recognized that corporate gains from sales of treasury shares are taxable if the shares are reacquired for investment. But it interpreted the Regulations as exempting such gains from tax if the corporation contractually obligates itself to buy the shares from, or resell them to, a selected class of persons—employees—or if its dominant motive is to compensate the employees rather than to make a profit. However, a gain is not any the less taxable to the recipient because derived from the performance of a contract.

or because other parties to the contract may also benefit. Nor is the corporation any the less dealing in its shares because the purchases or resales are restricted to a particular group, such as officers or employees. The crucial inquiry is whether the shares are purchased for retirement or for resale, not why or to whom the shares are resold. Had taxpayer bought and resold its shares on a stock exchange, there could be no doubt of the taxability of the resulting gain. That the shares were bought and resold directly between taxpayer and its stockholder-employees pursuant to a contract does not insulate it from tax liability. In a long line of cases involving the same question as is here presented, the Courts of Appeals have uniformly held the gains to be taxable and in so doing have properly dismissed as immaterial the factors deemed controlling by the court below. The most recent of these are *Commissioner* v. *Landers Corp.*, 219 F. 2d 188 (C. A. 6); *Commissioner* v. *H. W. Porter & Co.*, 187 F. 2d 939 (C. A. 3); *Commissioner* v. *Rollins Burdick Hunter Co.*, 174 F. 2d 698 (C. A. 7); *Commissioner* v. *Batten, Barton, Durstine & Osborn*, 171 F. 2d 474 (C. A. 2). Even the Tax Court, with whose prior decisions the court below expressed agreement, has since changed its position and now follows the holdings of the Courts of Appeals. *Farmers Mills* v. *Commissioner*, 22 T. C. 881.

The court below argued that no tax is involved in the retirement and reissue of stock and that to differentiate the sale of treasury stock would emphasize form over substance. This overlooks the

fact that there are materially different legal consequences involved in the two types of transactions. Moreover, if the retirement and reissue were merely a disguise for a preconceived purchase and sale, it is at least doubtful that the taxpayer could escape the tax consequences which would have been imposed. In any event, there is no need here to determine what the tax result would have been if the taxpayer had followed another course, for the undisputed fact remains that it did not do so; but for reasons of its own chose to treat the purchased shares as treasury stock and to resell them. Its tax liability stems from what it did, not from what it might have done.

The error of the court below is accentuated by its reliance upon *Eisner* v. *Macomber*, 252 U. S. 189. The question there involved—taxability of a stock dividend to the stockholder—is far removed from that here presented. Moreover, as this Court recently held in *Commissioner* v. *Glenshaw Glass Co.*, 348 U. S. 426, the *Macomber* decision was not meant to curtail the applicability of Section 22(a) in other situations. The gain here in question, like that involved in the *Glenshaw Glass Co.* case, constitutes an accretion to taxpayer's wealth falling clearly within the Section 22(a) definition of gross income.

Had Congress intended to except gains from sales of treasury shares from the sweeping coverage of Section 22(a) and, conversely, to disallow deductions of losses from such sales, it could readily have done so. It has done so in the Internal Reve-

nue Code of 1954, applicable to years after 1953. Congress created no such exception for years to which the 1939 Code applies.

ARGUMENT

The Gain Realized by Taxpayer from the Sale of Its Treasury Shares Is Includible in Its Gross Income Under Section 22(a) of the Internal Revenue Code of 1939 and the Applicable Treasury Regulations

Section 22(a) of the Internal Revenue Code of 1939[4] (*supra*, p. 2) comprehensively defines gross income as including "gains, profits, and income derived from * * * dealings in property * * * or gains or profits and income derived from any source whatever." The implementing Treasury Regulations (Section 29.22(a)-15 of Regulations 111 under the Code, *supra*, p. 3) provide in part that whether the acquisition or disposition by a corporation of its own shares gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, and that—

> if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another.

The question in this case is whether the difference between the amount paid by the taxpayer corporation to purchase shares of its own stock and the higher amount received upon their resale con-

[4] Unless otherwise noted, references to the Code are to the Internal Revenue Code of 1939.

stituted taxable income to it. The answer depends on whether taxpayer dealt in its own shares, within the purview of the Treasury Regulations, by purchasing them for resale, holding them as treasury stock pending their resale, and reselling them.

The material facts are not in dispute. All of taxpayer's common stock was originally issued to its executives (R. 23). Shortly after its organization the corporation entered into a written agreement with the stockholder-executives restricting ownership of the common stock to managing officials. The agreement provided that none of the stockholders would transfer his shares without the written consent of holders of seventy-five percent of the stock; that upon the death of a stockholder the corporation would purchase his shares at book value based upon the current net worth of the corporation; that at any time any stockholder could elect, or the holders of seventy-five percent of the stock could require him, to sell his shares to the corporation at the book value; and that shares purchased by the corporation could be resold to the remaining stockholders, or to any other person, on such terms as might be agreed upon by the corporation and the holders of seventy-five percent of the remaining shares. (R. 24-26, 44-51.) Pursuant to the agreement, taxpayer on a number of occasions between 1932 and 1943 purchased shares of its stock, placed them in its treasury, and resold them, the purchase and resale prices varying as the book valuation of the shares varied (R. 43, 79). Among such transactions was the purchase and re-

sale of the shares of one of taxpayer's chief stockholder-executives, Anderson. Upon Anderson's death in 1939 taxpayer purchased his shares from his estate at their then agreed book value of $50.79 per share, held them as treasury stock, and during the taxable year (fiscal year 1944) resold 6,500 of these shares to five stockholder-executives at the book value of $112.68 per share. (R. 26-27, 50-51, 77-79, 83.) The $402,285 difference between the total price paid for these shares ($330,135) and the total price received upon their resale ($732,420) was credited by taxpayer to its capital surplus account, but was not reported for income tax purposes. (R. 27, 38.) The Commissioner determined that the difference was taxable as long-term capital gain. (R. 30.)

The Court of Claims, disagreeing with all of the Courts of Appeals which have passed upon the question here presented,[5] as well as with the current view of the Tax Court,[6] held that no taxable

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[5] The decisions of the Courts of Appeals are listed and discussed *infra*, pp. 29 to 32.

[6] *Burrus Mills* v. *Commissioner*, 22 T.C. 881, decided the day after the decision below was filed. See also, *M. Conley Co.* v. *Commissioner*, 6 T.C. 250; *Superheater Co.* v. *Commissioner*, decided March 17, 1943 (1943 P-H T.C. Memorandum Decisions, par. 43,129); *Brown Shoe Co.* v. *Commissioner*, 45 B.T.A. 212; and *Pittsburgh Laundry* v. *Commissioner*, 43 B.T.A. 230.

The decision of the Court of Claims in the instant case is also inconsistent with its own prior decision in *Edwin L. Wiegand Co.* v. *United States*, 60 F. Supp. 464. While the court stated that this case was "distinguishable on its facts" (R. 22), we are unable to find any factual differences which warrant a difference in result.

gain was realized by taxpayer from the purchase and resale of the shares. Although at one point in its opinion the court below professed to approach the question as one of fact (R. 22-23), it is plain from the opinion as a whole that its decision rests upon what it conceived to be a proper interpretation of Section 22(a) and the applicable Treasury Regulations. This case is not factually different in any material respect from those involving the same question and decided differently by the Courts of Appeals, and the court below made no attempt to distinguish this case from any of those decided by the Courts of Appeals. It simply and flatly disagreed with the principles which those courts considered controlling, and applied entirely different legal criteria and standards of its own. Since the case turns upon a correct construction of the taxing statute and the Regulations, and the court below laid down rules of general applicability, its decision is reviewable as a question of law. *Bingham's Trust* v. *Commissioner*, 325 U.S. 365, 371; *Commissioner* v. *Rollins Burdick Hunter Co.*, 174 F. 2d 698, 702 (C.A.7); *Commissioner* v. *Batten, Barton, Durstine & Osborn*, 171 F. 2d 474, 477 (C.A. 2).

The disagreement with prior decisions stems chiefly from differing interpretations of the applicable Treasury Regulations, the court below construing the Regulations as rendering taxability of the gain dependent upon the taxpayer's reasons for buying and reselling its shares, whereas the Courts of Appeals regard motives and similar factors as immaterial. The court below not only

rejected the holdings of the Courts of Appeals insofar as taxability of the gain is concerned; it questioned the existence of a gain even though the taxpayer resold the shares for more than it paid for them. It is the Government's position that the long and unbroken line of decisions of the Courts of Appeals, rather than the contrary decision of the court below, represents the correct view.

A. *Taxpayer realized gain from the purchase and resale of its shares.*

No extended argument is needed to demonstrate that taxpayer realized a gain from the purchase and resale of the 6,500 shares in question. It paid $330,135 in cash to acquire the shares, and it received $732,420 in cash upon their resale,[7] thereby increasing its assets and net worth by the difference of $402,285. The difference between the cost and resale price of the shares represented economic gain in every sense of the term. Taxpayer "realized within the year an accession to income, if we take words in their plain popular meaning, as they should be * * *." *United States* v. *Kirby Lumber Co.*, 284 U.S. 1, 3. See also *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426; *General American Investors Co.* v. *Commissioner*, 348 U.S. 434; *Helvering* v. *Bruun*, 309 U.S. 461; *Helvering* v. *American Chicle Co.*, 291 U.S. 426; *Merchants' L. & T. Co.* v. *Smietanka*, 255 U.S. 509.

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[7] Taxpayer received notes for the resale price, but it is stipulated that their amount may be treated as cash for purposes of this case. (R. 26.)

In the *Kirby* case this Court held that a corporation which purchased its own bonds for less than their face amount realized taxable income in the amount of the difference, since its net worth was increased by that amount. A corporation which sells treasury shares at a price greater than cost likewise enhances its net worth in the amount of the difference. As was said in *Commissioner* v. *H. W. Porter & Co.*, 187 F. 2d 939, 941 (C.A. 3d), involving the very question here presented, the excess of the amount received over the amount paid for the shares "certainly looks like gain to a man in the street, whatever accountants might say about it." See also *Commissioner* v. *Landers Corp.*, 240 F. 2d 188, 191 (C.A. 9th); *Helvering* v. *Edison Bros. Stores*, 133 F. 2d 575, 579 (C.A. 8th), certiorari denied, 319 U.S. 752.

Although the court below specifically disclaimed that its decision was based on the theory that there can be no gain from the purchase and sale of treasury stock (R. 20), it does reiterate doubts, referring to *E. R. Squibb & Sons* v. *Helvering*, 98 F. 2d 69 (C.A. 2), that gain or loss can result when the transactions are priced on the basis of the value of the stock's proportionate share of the corporate assets. In part this doubt seems to stem from the accounting treatment customarily accorded dealings in treasury stock, i.e., no gain or loss is recorded on the profit and loss statement and the treasury stock, while held, is not

carried as an asset on the balance sheet.[8] But this has no bearing on whether from the tax viewpoint the corporation has realized a gain.[9] From an accounting standpoint, it would be confusing, and often misleading, to integrate the dealings of a corporation in its stock with its business functions. But this feature is not decisive, nor even significant, where the question is whether there was gain or profit "from any source whatever."

However, the court below questions whether there can be a gain when both purchases and sales are made at prices fixed by the value of the corporate assets attributable to the stock bought and sold. It is suggested that in each case the corporation paid or received the equivalent of the value of the stock. The error in this reasoning lies in treating the purchases and sales as isolated transactions. Actually the stock was bought at one price, was held during a period while it increased in value, and was sold at a price reflect-

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[8] Finney and Miller, *Principles of Accounting, Intermediate* (5th ed. 1953), 235-237, 284-291; Paton, *Accountants' Handbook* (3rd ed.) 1006-1014; Securities and Exchange Commission, Accounting Series, Release No. 6 (1938).

[9] The manner in which taxpayer recorded the transaction on its books is not, of course, determinative of whether gain was realized, or of taxability of the gain. *Bazley* v. *Commissioner*, 331 U.S. 737, 741; *Helvering* v. *Midland Ins. Co.*, 300 U.S. 216, 225; *Weiss* v. *Wiener*, 279 U.S. 333, 335; *Old Colony R. Co.* v. *Commissioner*, 284 U.S. 552, 562. As a matter of fact, taxpayer on its books credited the excess of the selling price over the cost of the treasury shares to its "capital surplus" account. (Finding 14, R. 27; R. 36-37; see also Findings 22-24, R. 28-29.)

ing the increase. This is gain to the corporation—a taxable entity apart from its stockholders[10]—just as truly as where any other property is sold at an appreciated value.

The court below also reasoned that the difference between the purchase and resale prices "represents largely, if not entirely, accumulated earnings of the corporation which have already been subjected to tax," and that consequently "it is rather difficult to comprehend how plaintiff corporation realized an accession to income." (R. 22.)[11] A simple illustration shows the fallacy of this reasoning. Suppose A, B and C form Corporation X, each contributing $1,000 for 10 shares of stock. After X has earned $300 (bringing its net worth to $3,300) it purchases A's shares for their proportionate value of $1,100 and holds them as treasury stock. X then has a net worth of $2,200 and B and C each own stock worth $1,100. X earns an additional $200 bringing its worth to $2,400. It resells the treasury shares to D at their proportionate value of $1,200. The end result is that the corporation's net worth has increased by $600 (from $3,000 to $3,600) comprised of $500 of

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[10] *Moline Properties v. Commissioner*, 319 U.S. 436; *National Carbide Corp. v. Commissioner*, 336 U.S. 422.

[11] There is no reason to suppose that all or even most of the increase in taxpayer's net worth between the purchase and resale dates reflected additional retained earnings, rather than an unrealized increment in the value of the corporate assets; and nothing in taxpayer's earned surplus account (R. 84-85) or elsewhere in the record justifies the inference. On the contrary, taxpayer's surplus account shows an entry, as of July 31, 1943, of over $7,000,000 as "appreciation" in stocks of subsidiaries. (R. 80.)

undistributed earnings plus $100 gain from the purchase and sale of the treasury stock. Although the increase in price resulted from the retention of corporate earnings, the added $100 came from D's pocketbook, not from the earnings of the taxpayer.

B. *The gain constitutes taxable income*

The gain realized by taxpayer—the difference between the purchase and resale price of the shares—is not immune from tax. It comes within the definition of gross income contained in Code Section 22(a), and the Court of Claims erred in holding that the Treasury Regulations place it beyond the reach of that section.

1. *The gain falls within Section 22(a)*

The gain unquestionably falls within the broad scope of Section 22(a), which defines gross income as including gains "derived from any source whatever." This sweeping language evinces a congressional intent to tax all kinds and forms of constitutionally taxable income, except those items explicitly excluded elsewhere in the statute. *Commissioner* v. *Glenshaw Glass Co.*, *supra*; *General American Investors Co.* v. *Commissioner*, *supra*; *Helvering* v. *Bruun*, *supra*; *Commissioner* v. *Jacobson*, 336 U.S. 28, 49; *Helvering* v. *Clifford*, 309 U.S. 331, 334; *Douglas* v. *Willcuts*, 296 U.S. 1, 9; *Irwin* v. *Gavit*, 268 U.S. 161, 166. As was only

recently said in the *Glenshaw* case, *supra* (pp. 429-430):

> This Court has frequently stated that this language was used by Congress to exert in this field "the full measure of its taxing power." * * * Congress applied no limitations as to the source of taxable receipts, nor restrictive labels as to their nature. And the Court has given a liberal construction to this broad phraseology in recognition of the intention of Congress to tax all gains except those specifically exempted.

There is no provision in the Code which even remotely suggests that Congress intended to exempt corporate gains derived from sales of treasury stock from the all-embracive coverage of Section 22(a). Nor has the court below pointed to any such provision.[12]

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[12] For years after 1953, Section 1032 of the Internal Revenue Code of 1954 removes gains or losses from sales of treasury stock from the area of taxable gains and deductible losses, by specifically providing that "No gain or loss shall be recognized to a corporation on the receipt of money or other property in exchange for stock (including treasury stock) of such corporation." No comparable provision appears in the 1939 Code. The committee reports accompanying the 1954 Code state, with reference to Section 1032, that its purpose was "to remove the uncertainties of present law." H. Rep. No. 1337, 83d Cong., 2d Session, p. A268; S. Rep. No. 1622, 83d Cong., 2d Sess., p. [illegible]. The only uncertainty in the law at the time of those reports stemmed from a difference of opinion between the Tax Court and the Courts of Appeals as to the proper interpretation of the pertinent Treasury Regulations — a difference which has since disappeared. See *Burrus Mills v. Commissioner*, 22 T.C. 881.

2. The Treasury Regulations do not exempt the gain from tax.

Although the taxing statute itself contains no provision according tax exemption to gains from sales of treasury stock, the Court of Claims purported to find a basis for exemption in the Treasury Regulations addressed to Section 22(a). It construed the Regulations as subjecting such gains to tax only if the corporation purchased its shares "as an investment" and resold them "at opportune times" (R. 20), but as exempting the gains from tax if the corporation acting without a profit motive contractually "obligated" itself in advance to purchase the shares and resell them to a particular class of persons, such as employees (R. 21-22).[13]

[13] Even under the court's own narrow interpretation of the Regulations, the gain in question would appear to be taxable. The contract between taxpayer and its stockholders required taxpayer to buy shares only upon the death or the election of a stockholder; and it did not require it to sell any shares at any time. The contract *authorized* holders of seventy-five percent of the stock to require taxpayer to buy shares at any time from any stockholder, and to resell shares at any time to any remaining stockholder or other person (R. 24-26, 44-48), thus permitting taxpayer to buy and resell its shares for such purposes and at such times as the holders of seventy-five percent of the stock saw fit. Nothing in the contract obligated taxpayer to resell during the taxable year or at any other time the 6,500 shares in question which it bought from the Anderson estate and was holding in its treasury. The shares were resold during the taxable year (to remaining stockholders) only because holders of seventy-five percent of the stock chose at that time to direct taxpayer to do so. (R. 50-51.) Moreover, taxpayer's alleged obligation to buy and sell its shares was created by

We need not stop to consider whether, if the Regulations are susceptible of only the narrow construction placed upon them by the court below, they might be deemed invalid because inconsistent with the plain legislative intent expressed in Section 22(a). Cf. *Manhattan Co.* v. *Commissioner*, 297 U.S. 129; *Commissioner* v. *Landers Corp.*, 210 F. 2d 188, 191 (C.A. 6th).[14] For no such interpretation is demanded, or even justified, by the terms of the Regulations. Far from restricting the scope of Section 22(a), the applicable Treasury Regulations implement its purpose by requiring inclusion in the gross income of a corporation of any gain derived from a purchase and resale of treasury shares, regardless of whether the transaction takes place pursuant to a contract, or of whether the purchasing and selling stockholders are also employees of the corporation, or of whether the motive underlying the transaction is to profit the corporation or the stockholder-employees or both.

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agreement between it and its controlling stockholders, and could be changed or terminated at the latters' will. (R. 26.) Accordingly, even assuming, as the court below held, that the Regulations are to be construed as covering only situations in which a corporation is free to buy or sell its shares at opportune times, the instant arrangement would not place the gain in question beyond the pale of the Regulations.

[14] In *Helvering* v. *Reynolds Co.*, 306 U.S. 110, it was held that the Regulations in force prior to 1934, expressly providing that a corporation realizes no gain or loss from the purchase or sale of its own stock, had received implied congressional approval by virtue of repeated re-enactments of Section 22(a).

Section 29.22(a)-15 of Treasury Regulations 111, *supra*, p. 3, provides in part that "the receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss," whether the issue price is lower or less than the par or stated value of the stock. Section 29.22(a)-20 of the same Regulations, *supra*, pp. 3-4, provides in part that "No gain or loss is realized by a corporation from the mere distribution of its assets in kind in partial or complete liquidation," i.e., upon a redemption of its shares,[15] whether the assets have appreciated or depreciated in value since their acquisition. However, Section 29.22(a)-15 further provides that "if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another."[16] These Regula-

[15] Under Code section 115(c) distributions in complete or partial liquidation are treated as payments in exchange for the stock. Section 115(i) defines a partial liquidation as "a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock."

[16] The same section of the Regulations also requires recognition of gain or loss if a corporation receives its own stock in payment of property sold by it, or in satisfaction of indebtedness to it. *See Commissioner* v. *S. A. Woods Mach. Co.*, 57 F. 2d 635 (C.A. 1st certiorari denied, 287 U.S. 613; *Commissioner* v. *Boca Ceiga Development Co.*, 66 F. 2d 1004 (C.A. 3d); *Trinity Corp.* v. *Commissioner*, 127 F. 2d 604 (C.A. 5th), certiorari denied, 317 U.S. 651. This portion of the Regulations is not directly involved here.

tions are long-standing [17] and under familiar rules must be deemed to have received implied legislative approval by virtue of successive reenactments of Section 22(a), the statutory provision to which they are addressed. *Helvering* v. *Winmill*, 305 U. S. 79, 82-83; *Helvering* v. *Reynolds Co.*, 306 U. S. 110; *Commissioner* v. *Flowers*, 326 U. S. 465, 469; *Lykes* v. *United States*, 343 U.S. 118, 127. Every court passing upon the taxability of corporate gains from sales of treasury stock has upheld the validity of the Regulations, in a variety of circumstances and over a period of almost two decades. See, e.g., *Commissioner* v. *H. W. Porter & Co.*, *supra*, p. 940; *Commissioner* v. *Landers Corp.*, *supra*, p. 191; *Commissioner* v. *Rollins Bardick Hunter Co.*, 174 F. 2d 698 (C.A. 7th). And the court below likewise assumed their validity, resting its decision on what it conceived to be a proper construction of the Regulations. (R. 20-22.)

When the above provisions of the Regulations are read in conjunction with each other, it is clear that a corporation does not realize a taxable gain or deductible loss by (1) issuing new stock in exchange for capital needed in its business, or (2) redeeming outstanding stock in exchange for capital no longer needed in the business. Either of such transactions, standing by itself, constitutes a nontaxable readjustment of the corporation's capital. In the former case—an original issue of

[17] Provisions corresponding to Section 29.22(a)-15 of Regulations 111 appeared in the Regulations issued under all revenue acts since the 1934 Act. Provisions corresponding to Section 29.22(a)-20 of Regulations 111 appeared in the Regulations issued under all revenue acts since the 1918 Act.

stock—the corporation is merely obtaining the capital with which to commence or expand its business; in the latter case—reacquisition of the stock in partial or complete liquidation—it is merely returning the capital upon a contraction or termination of the business.

On the other hand, it is equally plain from the Regulations that if the corporation reacquires some of its shares, holds them in its treasury, and resells them, then the reacquisition and resale of the shares may not be viewed as separate and unrelated readjustments of the corporation's capital. In such a case the corporation patently does not reacquire its shares in order to decrease its capital, nor does it issue new shares in order to increase its capital. On the contrary, by placing the reacquired shares in its treasury and reselling them the corporation "deals in its own shares as it might in the shares of another corporation," within the purview of the Regulations, and the difference between the purchase and resale price must be reflected in a computation of the corporation's taxable income just as if the corporation were buying and selling any other property. If any doubt otherwise existed as to the purpose and meaning of the pertinent Regulations, it is dispelled by the history of Section 29.22(a)-15 of Regulations 111, which shows that it was designed to change and supplant preexisting Regulations denying recognition to gains or losses from dealings by a corporation in its own shares.[18]

[18] Originally, the Regulations provided that gain from the sale of treasury stock was taxable. Article 98 of Regulations 33 (Rev.) under the Revenue Act of 1916, as amended by the

In short, under the Regulations the crucial inquiry is whether the transaction, viewed from beginning to end, is a readjustment of the corporation's capital or a dealing in its shares, and the answer depends upon whether the reacquired shares are retired or resold. It is one thing for a going corporation to reacquire some of its stock in contraction of its business, or to issue new stock in expansion of its business. The applicable Treasury

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Revenue Act of 1917. Thereafter, until 1934, the Regulations provided that no gain or loss is realized if a corporation purchases or sells its own stock. Article 542 of Regulations 45 (1918 Act); Article 543 of Regulations 62, 65, and 69 (1921, 1924, and 1926 Acts); Article 66, Regulations 74 and 77 (1928 and 1932 Acts). In 1934 the Regulations were again changed so as to recognize such gains or losses, and thereafter they remained the same under all subsequent Revenue Acts and under the Internal Revenue Code of 1939. Article 22(a)-16 of Regulations 86, 94 and 101 (1934, 1936, and 1938 Acts); Section 19.22(a)-16 of Regulations 103 and Section 29.22 (a)-15 of Regulations 111 under the Code. See also G.C.M. 16651, XV-2 Cum. Bull. 130 (1936). The 1934 change stemmed from decisions at variance with the Regulations previously in force. See *Commissioner* v. *S. A. Woods Mach. Co.*, *supra*; *Commissioner* v. *Air Reduction Co.*, 130 F. 2d 145 (C.A. 2d), certiorari denied, 317 U.S. 681; *Commissioner* v. *Rollins Burdick Hunter Co.*, 174 F. 2d 698 (C.A. 7th). As pointed out in the *Rollins* case (pp. 699-700), the Regulations as amended in 1934 followed the language of the opinion in the *Woods* case.

The Commissioner's attempt to make the 1934 change retroactive (T.D. 4430, XIII-1 Cum. Bull. 36 (1934)) was held invalid, on the ground that the prior Regulations had acquired the force of the law. *Helvering* v. *Reynolds Co.*, 306 U.S. 110. However, this did not preclude prospective application of the amended Regulations (*Helvering* v. *Wilshire Oil Co.*, 308 U.S. 90; *Helvering* v. *Reynolds*, 313 U.S. 428), and, as the court below noted (R. 19-20), their applicability to post-1934 transactions has been uniformly sustained.

Regulations expressly recognize that neither of such transactions *per se* gives rise to taxable gain or deductible loss to the corporation. But it is quite another matter for the corporation to reacquire its own shares with a view to reselling them, retain them as treasury stock, and then resell them. A corporation engaging in the latter type of transaction manifestly has no intention permanently to reduce its capital, but "deals" in its shares as it "might" in those of another corporation or in any other property; and the Regulations are equally explicit in requiring tax recognition of gains or losses resulting from such transactions.

The Courts of Appeals in a long line of carefully considered opinions have uniformly held that a corporation which reacquires its own shares, holds them in its treasury, and later resells them at a price greater than cost, realizes a taxable gain under Section 22(a) and the applicable Regulations.[19] The gain has been held taxable notwithstanding the fact that the corporation had no profit motive, and that it contractually obligated itself in advance to reacquire the shares and reissue them to particular individuals or groups of individuals (e.g., employees) at previously fixed prices. *Commissioner* v. *Landers Corp.*, 210 F. 2d 188 (C.A. 6th); *Commissioner* v. *H. W. Porter & Co.*, 187 F. 2d 939 (C.A. 3d); *Commissioner* v. *Rollins Burdick Hunter Co.*, 174 F. 2d 698 (C.A. 7th); *Commissioner* v. *Batten, Barton, Durstine & Osborn*, 171 F. 2d 474 (C.A.

[19] As previously noted, the Tax Court now agrees with the Courts of Appeals. *Burrus Mills* v. *Commissioner*, *supra*.

2d), certiorari denied, 338 U.S. 816; *Aviation Capital v. Pedrick*, 148 F. 2d 165 (C.A. 2d), certiorari denied, 326 U.S. 723; *Dow Chemical Co. v. Kavanagh*, 139 F. 2d 42 (C.A. 6th); *United States v. Stern Bros. & Co.*, 136 F. 2d 488 (C.A. 8th); *Brown Shoe Co. v. Commissioner*, 133 F. 2d 582 (C.A. 8th); *Helvering v. Edison Bros. Stores*, 133 F. 2d 575 (C.A. 8th), certiorari denied, 319 U.S. 752; *Commissioner v. Air Reduction Co.*, 130 F. 2d 145 (C.A. 2d), certiorari denied, 317 U. S. 681; *Allen v. National Manufacture & Stores Corp.*, 125 F. 2d 239 (C.A. 5th), certiorari denied, 316 U.S. 679; cf. *Commissioner v. S. A. Woods Mach. Co.*, 57 F. 2d 635 (C.A. 1st), certiorari denied, 287 U.S. 613. As was pointed out in the *Landers* case, *supra*, all of the Courts of Appeals (p. 491)—

> have construed the Regulations as meaning that regardless of the original purpose of the corporation in purchasing its shares, if the corporation does not actually cancel and retire the shares so purchased but later sells them, regardless to whom they are sold, the corporation has sold an asset in the same way as when it sells the shares of another corporation which it might own, and that any resulting gain is the same type of taxable income as would result from a profit derived from the sale of any other asset.

Essentially, the rationale of the decision is that the purchase and resale of treasury stock do not constitute successive downward and upward ad-

justments of the corporation's capital, but in substance and effect are interrelated component steps in a buying-selling transaction, the resulting gain from which constitutes taxable income under Section 22(a) and the applicable Regulations. As was said in the *Porter* case, *supra*, pp. 941-942, which involved substantially the same situation as is here presented:

> But the problem is not a new one. Every court passing upon the Regulation has upheld it, in a variety of circumstances and over a period of some ten years. The courts have uniformly upheld the taxation of the gain from the sale of treasury stock under it. At this late date we do not feel constrained to disagree. We share the conclusion that the regulation is a valid interpretation of Section 22(a) of the Internal Revenue Code, 26 U.S.C.A. § 22(a) and that it permits the taxation as gain to a corporation of the difference between the purchase price and the selling price of its treasury shares.
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> * * * * * *
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> The Commissioner takes the position that whenever a corporation reacquires its own shares, for the purpose of reselling them, holds them in its treasury instead of retiring them and later does sell them, it is dealing in its shares as in the shares of another and thus comes within the Regulation. He says that so

> long as there is no readjustment in capital structure the economic gain or loss to the corporation is the same regardless of the motive of the corporation in dealing in its own stock.
>
> We agree with the Commissioner. * * * The emphasis has been on the final result from the buying and selling and not on motive. The determining factor has not been whether the purpose of the dealings could have been achieved by dealing in the stock of another corporation, but whether the transaction resulted in a "capital adjustment."

The court below in effect treated the purchase and resale of the shares in question as two separate and independent transactions, each constituting an adjustment of taxpayer's capital. It regarded the purchase as though it were a retirement of stock in partial liquidation of the business, and the resale as though it were an original issuance of new shares for new capital. But when the transaction is viewed in its entirety, as it must be (cf. *Commissioner* v. *Court Holding Co.*, 324 U.S. 331; *Arrowsmith* v. *Commissioner*, 344 U.S. 6), the conclusion is inescapable that what occurred was in substance and effect merely a change in the ownership of the stock—a purchase of the shares by taxpayer from one of the stockholders (the Anderson estate), and a resale of the same shares to other stockholders. There was no change in taxpayer's capital structure, either upon the purchase or the resale. The purchased shares admittedly were not retired, but

were held as treasury stock pending their resale. Nor were any new shares issued; indeed, taxpayer could not have issued new shares, since it had no authorized unissued stock. (R. 28-29.) Moreover, the purchase and resale of the shares in question were not isolated events, but were part and parcel of a purchase-resale program. As the court below found, it was taxpayer's policy from the beginning to purchase shares from outgoing executives and resell them to remaining or incoming executives (R. 24, 29), a policy which was incorporated into a written contract between the corporation and its stockholders (R. 24-26). On no less than fifteen occasions between 1932 and the taxable year, taxpayer purchased shares of its stock or sold shares held in its treasury. (R. 43.)[20] Such recurring purchases and resales of its own shares may hardly be viewed as a series of successive contractions and expansions of taxpayer's business capital. What is more, the purchases and resales bore no relationship to taxpayer's capital needs; they were made pursuant to a prearranged plan embodied in a contract, and for the avowed purpose of restricting ownership of the stock to the managing officials of the corporation. (R. 24-26.)[21]

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[20] The taxpayer was authorized to buy and sell its own shares at such prices and at such terms as its board of directors determined. (R. 54.) See also Revised Code of Delaware (1935), Section 2051.

[21] Gains from sales of treasury shares have been held taxable even though the sales were made to secure needed additional working capital. See *Aviation Capital* v. *Pedrick*, *supra*; *Allen* v. *National Manufacture & Stores Corp.*; *Commissioner*

Any one of the above features is incompatible with the notion that taxpayer's purchases and resales of its shares constituted readjustments of its capital. Viewed collectively, they demonstrate conclusively that the sole purpose and net effect of the entire transaction was to substitute one stockholder for another. Under no tenable theory may the transaction be fitted into those portions of the Regulations which treat as nontaxable events, from the corporation's viewpoint, either a reduction of stock in partial liquidation or an original issue of new stock. Rather it falls within that portion of the Regulations which requires the taxation of gains realized by a corporation from dealings in its own shares. The situation here is essentially no different from those presented in numerous other cases in which the Courts of Appeals have consistently refused to accord tax exemption to similar gains. Indeed, the instant case bears a striking resemblance to *Commissioner* v. *Rollins Burdick Hunter Co., supra.* There as here the corporation pursuant to a contract purchased its own shares from former employees, put them in its treasury, and later sold them to deserving employees at book value prices fixed by the contract. Agreeing with the decisions of other Courts of Appeals in analogous cases, the court held that the excess of the sales price over cost represented taxable gain. After reviewing the

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v. *Batten, Barton, D. & O., supra; Dow Chemical Co.* v. *Kavanagh, supra; Commissioner* v. *Landers Corp., supra. A fortiori,* they are taxable where as here no such purpose is present.

history of the applicable Regulations the court stated (p. 701):

> The capital structure of the taxpayer never changed. It was authorized to issue 1,000 shares, which it did issue and never canceled. The fact that at various times it purchased and resold some of its own shares merely resulted in a change of identity of its shareholders. Such transactions can hardly be considered a readjustment of capital structure. We are in agreement with the cases previously discussed, wherein the various circuits have held the gains from similar transactions to be taxable income. We think that a profit upon the sale by a corporation of its treasury stock under the circumstances of this case, is within the statutory definition, "gains or profits and income derived from any source whatever."

See also Commissioner v. *Landers Corp., supra; Commissioner* v. *H. W. Porter & Co., supra; Commissioner* v. *Batten, Barton, D. & O., supra; Aviation Capital* v. *Pedrick, supra; Commissioner* v. *Air Reduction Co., supra; Helvering* v. *Edison Bros. Stores, supra; United States* v. *Stern Bros. & Co., supra.*

Had taxpayer bought and resold its shares on a stock exchange, there could be no doubt whatever of the taxability of the resultant gain, even under the narrow construction placed upon the Regulations by the court below. That the purchases and resales were made directly between the corporation

and its employees, pursuant to a preconceived plan embodied in a contract with its stockholders, does not alter the true nature and tax effect of the transaction. A corporation "deals" in its own shares, within the meaning of the Regulations, no less when it contractually obligates itself to buy the shares from and resell them to its employees at previously agreed prices than when it buys from and resells to strangers in the market place. Moreover, by engaging in such activities the corporation deals in its shares as it "might" in those of another corporation, within the meaning of the Regulations, for shares of another corporation—or indeed any other property—"might" be bought and sold by a corporation in discharge of a contractual obligation to its employees or to some other selected group of persons.[22] Certainly a corporation which sold property other than its own shares would not be insulated from tax liability on the attendant gain, or be foreclosed from deducting an attendant loss, merely because the property was sold to its employees pursuant to a contract. No valid reason appears, and none is suggested by the court below, for creating a different rule with respect to gain or loss realized by a corporation from the pur-

[22] The phrase "as it might in the shares of another corporation," appearing in the Regulations, was taken from the opinion of the First Circuit Court of Appeals in *Commissioner* v. *S. A. Woods Mach. Co.*, *supra*. As was pointed out in the *Rollins* case, *supra*, p. 700, the phrase was employed in that opinion and is used by the Commissioner in the Regulations as "illustrative," and was not intended to be restrictive.

chase and resale of its own shares. The Regulations as interpreted by all of the appellate courts which have passed upon the question properly preclude the use of a different rule.[23]

In disagreeing with the uniform holdings of the Courts of Appeals the court below relied upon a mixture of several theories. We submit that none of them has merit.

1. Acknowledging that corporate gains from sales of treasury shares are taxable if the shares are purchased "as an investment" (R. 20), the court below regarded the instant gain as tax-free because the transaction was motivated by a desire to reward the employee-stockholders and provide an incentive for their efforts rather than by a desire to make a profit for the corporation itself (R. 20-21). But even granting these were the only

[23] In the language of the Court in *Helvering* v. *Edison Bros. Stores*, 133 F. 2d 575 (C.A. 8), at 581—

> The argument of the taxpayer is that the sale of its own stock to its employees, under a plan adopted by the corporation for the purpose of creating and sustaining employee interest in the affairs of the corporation, is not dealing in its own stock by the corporation as it might deal in the shares of another corporation. The point is made that the purchase and sale of the shares in another corporation could not satisfy the essential purpose of the employee purchase plan. This, of course, is true but immaterial. The material fact is that the corporation bought and sold its own stock at a profit dealing, in controlling aspects of the transaction, as it might have dealt with the stock of another corporation. The fact that these profitable sales were made to employees is not alone determinative of the character of the transaction viewed as a whole. We think the transaction clearly within the department's regulations.

motives underlying the program, the fact remains that the corporation did receive more for the shares than it paid for them and hence realized a profit from the transaction. A taxpayer obviously does not escape tax on a realized gain merely because the transaction from which it flows has a motive other than gain. The economic substance and effect of the transaction rather than the motives of the parties governs its tax significance, and the courts have properly refused to consider absence of a profit motive as a ground for exempting similar gains from tax. "Once it is accepted that there is gain or loss taxwise when a corporation buys and resells its own stock without retiring it, there appears no basis for any inquiry into motive." *Commissioner* v. *H. W. Porter & Co., supra*, p. 941. See also *Commissioner* v. *Rollins Burdick Hunter Co., supra*, p. 702; *Commissioner* v. *Landers Corp., supra*, p. 191; *Commissioner* v. *Button, Barton, D. & O., supra*, p. 476; *Aviation Capital* v. *Pedrick, supra*, p. 167; *Commissioner* v. *Air Reduction Co., supra*, p. 148. When compared to the *Landers* case, for example, the instant case is an *a fortiori* one for taxing the gain. There the corporation did not even intend to resell the shares when it purchased them but later decided to resell them to employees in order to obtain additional capital (p. 189). Here the taxpayer purchased its shares for the very purpose of reselling them to employees.

2. Equally unsound is the somewhat related theory advanced by the court below, namely, that the gain escapes tax because taxpayer contractually

"obligated" itself to purchase the shares from withdrawing stockholder-employees and to resell them to other employees at an agreed book-value figure. (R. 21-22.) Income does not cease to be taxable because it is derived from the performance of a contract. As was said in the *Rollins* case, *supra*, p. 702, "a contractual obligation to sell to employees does not remove the resulting gain from taxation." Indeed, as we previously noted, the contractual feature of the arrangement "serves to confirm the correctness of the Commissioner's position that the purpose and effect of the entire transaction was a change in the identity of taxpayer's stockholders, not a readjustment of its capital. This same feature has been relied upon by the taxpayers in other cases, and has been repeatedly rejected by the Courts of Appeals, as a ground for relieving the corporation of tax liability. See, e. g. *Commissioner* v. *H. W. Porter & Co., supra; Commissioner* v. *Rollins Burdick Hunter Co., supra; Commissioner* v. *Batten, Barton, D. & O., supra; Commissioner* v. *Air Reduction Co., supra; Aviation Capital* v. *Pedrick, supra; Helvering* v. *Edison Bros. Stores, supra; United States* v. *Stern Bros. & Co., supra.* These cases correctly hold that corporate gains from sales of treasury shares are taxable under Section 22(a) and the implementing Treasury Regulations irrespective of whether the corporation obligates itself in advance to purchase and resell the shares, or of whether the resales are made to employees or to outsiders. The gain "must be treated in the same way for tax purposes

whether the reason for the purchase of the shares is to carry out an existing obligation or is to take advantage of what seems to be a desirable business opportunity" (*Aviation Capital* v. *Pedrick*, *supra*, p. 167), for the "presence of contract restrictions and obligations did not put the resulting gain from actual purchases and sales beyond the reach of the statute as interpreted by the regulations" (*Commissioner* v. *Rollins Burdick Hunter Co.*, *supra*, p. 702).

3. As a further ground for its decision, the court below expressed "some doubt as to whether a corporation's purchasing and selling its own stock is not really a capital transaction." (R. 21.) This theory does nothing more than pose the basic question presented. Indeed it begs the issue by assuming that a profitable purchase and resale of treasury stock as a matter of law represents a tax-free readjustment of the corporation's capital, rather than a taxable transaction. Labeling a purchase-resale transaction a "capital transaction" furnishes no solution to questions of taxability. While the attendant gain or loss may be entitled to capital gain or loss treatment (see Section 117), the gain or loss must nonetheless be taken into account in computing taxable income.[24]

4. The court below further held that "the basis for the Circuit Courts' decisions is one of form only in that it rests entirely on the failure of the

[24] The Commissioner treated the gain here in question as long-term capital gain. (R. 30.)

corporation to go through the formal mechanics of actually retiring the stock and issuing new stock." (R. 21.) In other words, the court felt that the tax on a gain from a purchase-resale transaction could be avoided simply by retiring the purchased shares and issuing new ones, and that therefore the gain should not be taxed even though such steps are not taken and the shares are treated as treasury stock. This theory is fallacious for several reasons.

(a) To begin with, the differences between a purchase and resale of outstanding (treasury) stock, on the one hand, and a retirement of outstanding stock and an issuance of new stock, on the other, are more than matters of form. The corporation's capital structure is unaffected by a purchase and resale of previously issued and outstanding shares, whereas there is a reduction of its capital when such shares are retired and an increase of its capital when new shares are issued.[25] Accordingly, treasury shares may be sold free of the statutory or charter restrictions which usually surround the issuance of new shares. See *Commissioner* v. *Batten, Barton, D. & O.*, *supra*, pp. 476-477; *Commissioner* v. *Landers Corp.*, *supra*, pp. 191-192; *Borg* v. *International Silver Co.*, 11

[25] The general rule is that shares are not automatically cancelled and retired by the mere fact of purchase by the corporation. See Ballantine, *Manual of Corporation Law and Practice*, 233 (1930). The rule applies in Delaware, the state of taxpayer's incorporation, which prescribes the method for retiring stock in reduction of capital. See Revised Code of Delaware (1935), Section 2060.

F. 2d 147 (C. A. 2d).[27] A corporation which for reasons of its own chooses to avail itself of the advantages accorded by state law to treasury shares, is in no position to complain if for tax purposes the Government likewise recognizes a difference between the two.[28]

(b) Nor is there any warrant for the tacit assumption by the court below that a corporation could defeat the tax on a gain from a purchase and resale of the shares (or lose its rights to deduct a resulting loss) by merely retiring the purchased shares and issuing new ones. It is axiomatic that tax consequences flow from the substance rather than the form of a transaction, and in harmony with that principle this Court has many times held that what is essentially a single integrated transaction may not be broken up into its component steps. *Commissioner* v. *Court Holding Co.*, 324 U.S. 331; *Gregory* v. *Helvering*, 293 U.S. 465;

[28] For example, treasury shares, unlike new shares, may ordinarily be sold for less than par or stated value, free of subscription liability, and free of pre-emptive rights of stockholders. See Ballantine, *supra*, pp. 232-233, 422, 681; Revised Code of Delaware (1935), Sections 2046-2052; *Belle Isle Corp.* v. *MacBean*, 30 Del. Ch. 373, 379-380; *Karasik* v. *Pacific Eastern Corp.*, 21 Del. Ch. 81; *Kingston* v. *Home Life Ins. Co.*, 11 Del. Ch. 258, 263-264; *Yasik* v. *Wachtel*, 25 Del. Ch. 247, 252. In this case no preemptive rights attached to the common stock. (R. 27.)

[27] Whether reacquired shares are held as treasury stock or are retired will affect not only the federal income tax liability of the corporation, but that of the stockholder from whom the shares are reacquired. See Code Section 115(c), (g) and (i); *Alpers* v. *Commissioner*, 126 F. 2d 58, 60 (C.A. 2d); *Kirschenbaum* v. *Commissioner*, 155 F. 2d 23, 25 (C.A. 2d), certiorari denied, 329 U.S. 726; *Amelia H. Cohen Trust* v. *Commissioner*, 121 F. 2d 689, 691 (C.A. 3d).

Minnesota Tea Co. v. *Helvering*, 302 U.S. 609; *Higgins* v. *Smith*, 308 U.S. 473. If the transaction viewed as a whole is in reality a purchase and resale of the shares, the corporation should not escape tax on the attendant gain simply by going through the motions of retiring the reacquired shares and replacing them with an equivalent number of new ones. Cf. *Commissioner* v. *Landers Corp.*, *supra*, p. 192. To hold otherwise would exalt form above substance by permitting the corporation to disguise what in effect is but a substitution of stockholders—a purchase and resale of outstanding shares—as two independent and unrelated transactions: (1) a reduction of capital in partial liquidation of the business, followed by (2) an increase of capital in expansion of the business. Certainly a corporation which bought and sold its shares on a stock exchange could not circumvent the tax on the gain simply by cancelling the purchased shares and issuing new ones. The taxability of the gain likewise does not depend on the mechanics employed where, as here, the shares are closely held and are bought and sold directly between the corporation and its stockholders. The transaction would no more constitute a bona fide readjustment of the corporation's capital in the one case than in the other. It would produce nothing more than a change in the identity of the stockholders.[28]

[28] While state law variations as to the method of decreasing or increasing corporate capital would not be controlling for federal income tax purposes (cf. *Lyeth* v. *Hoey*, 305 U.S. 188, 194; *Helvering* v. *Stuart*, 317 U.S. 154, 161; *United*

(c) In any event, taxpayer's tax liability depends upon what it actually did, not upon what it might have done. A taxpayer does not escape tax liability on a taxable transaction, merely because it might have chosen a nontaxable method for achieving the same objective. *Founders General Co.* v. *Hoey*, 300 U.S. 268, 275; *United States* v. *Phellis*, 257 U.S. 156, 173; *Commissioner* v. *Rollins Burdick Hunter Co.*, *supra*, p. 701; *Commissioner* v. *Landers Corp.*, *supra*, p. 192; *Aviation Capital* v. *Pedrick*, *supra*, p. 167; *Dow Chemical Co.* v. *Kavanagh*, *supra*, p. 46. In the words of Mr. Justice Brandeis in the *Founders* case, *supra*, p. 275:

> It is suggested that in each case the taxpayer might have attained his ultimate purpose by a form of transaction which would not have subjected him to the tax. The suggestion, if true, furnishes no reason for relieving him of tax when, for whatever reason, he chooses a mode of dealing within the terms of the Act. * * * To make the taxability of the transaction depend upon the determination whether there existed an alternative form which the statute did not tax would create burden and uncertainty.

States v. *Gilbert Associates*, 345 U.S. 361, 364), it is noteworthy that even for purposes of applying the state corporation law, such a transaction would not be treated as a bona fide capital readjustment. See *Starring* v. *American H. & F. Corp.*, 21 Del. Ch., 380, 389, affirmed, 21 Del. Ch. 431.

Accordingly, it is unnecessary here to decide whether the gain in question would have been taxable if taxpayer had retired the purchased shares and replaced them with new ones. Whatever might be the tax result in such a hypothetical case, there can be no question as to the result where as here the shares are not retired but are purchased for resale and treated as treasury stock in the interim. In such a case it is abundantly clear that the purchase and resale do not constitute a bona fide partial liquidation of the corporation and a later original issue of stock for new capital. On the contrary, as the Courts of Appeals have uniformly held, the corporation then "deals in its own shares as it might in the shares of another corporation" within the meaning of the Regulations.

5. The reliance placed by the court below upon certain decisions of the Tax Court (R. 20-21) is misplaced, for the Tax Court has since shifted its position to conform with that of the Courts of Appeals. *Burrus Mills* v. *Commissioner*, 22 T.C. 881. The court below now stands alone in holding gains from sales of treasury shares to be tax-free. To permit the decision below to stand would grant to the taxpayer corporation a tax benefit which for over twenty years has been denied to other corporations similarly situated.

6. The error of the court below is made the more evident by its reliance (R. 23) upon *Eisner* v. *Macomber*, 252 U.S. 189. The question there decided was far different from the one here presented. It was there held that the distribution of

a stock dividend did not constitute a realized gain to a stockholder, but merely changed the form of his capital investment, since he had received nothing out of the corporation's assets for his separate use and benefit. As this Court only recently pointed out, the decision in that case "was not meant to provide a touchstone to all future gross income questions." *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 431. See also *General American Investors Co.* v. *Commissioner*, 348 U.S. 434. Here, as in the *Glenshaw* and *General American Investors Co.* cases, the taxpayer realized an actual gain. The gain consisted of the difference between the cost and the selling price of its shares, and it unquestionably falls within the sweeping scope of Section 22(a). In the language of this Court in the *Glenshaw* case (p. 431): "Here we have instances of undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." See also *United States* v. *Kirby Lumber Co.*, 284 U.S. 1; *Helvering* v. *Braun*, 309 U.S. 461.

Exceptions to the broad coverage of Section 22(a) should be made by Congress, not the courts. *Commissioner* v. *Glenshaw Glass Co.*, *supra*. Had Congress wished to carve out an exception to Section 22(a) in favor of corporate gains from sales of treasury shares, it could readily and simply have done so. It did do so in Section 1032 of the Internal Revenue Code of 1954, applicable to years after 1953.[29] Since the present case involves a

[29] See fn. 12, *supra*. This section correspondingly prohibits deduction of losses resulting from sales of treasury shares.

prior taxable year, that section is not applicable here. The tax consequences of gains or losses from dealings in treasury stock during years prior to 1954, for this taxpayer and all other corporations, are governed by the provisions of the 1939 Code.

CONCLUSION

The judgment of the Court of Claims should be reversed.

Respectfully submitted.

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